

**U.S. Department of Energy  
Office of Inspector General  
Office of Audit Services**

---

**REPORT OF THE OFFICE OF INSPECTOR GENERAL  
ON THE DEPARTMENT'S SYSTEM OF INTERNAL CONTROLS**

---

The Secretary  
U.S. Department of Energy

We audited the consolidated financial statements of the Department of Energy (Department) for the year ended September 30, 1997, and have issued our report thereon dated December 29, 1997, except for Note 13, as to which the date is January 30, 1998, and Note 16, as to which the date is February 19, 1998.

The management of the Department is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. A system of internal controls should provide management with reasonable, but not absolute, assurance that the following objectives are met:

1. Transactions are executed in accordance with management's authorization and are properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with applicable accounting policies and to maintain accountability over assets.
2. Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.
3. Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and are in compliance with any other laws and regulations that Office of Management and Budget (OMB), Departmental management, or the Inspector General have identified as being significant and for which compliance can be objectively measured and evaluated.
4. Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Department for the year ended September 30, 1997, we considered its internal controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on the system of internal controls. Our consideration included obtaining an understanding of the significant internal control policies and procedures, determining whether they had been placed in operation, assessing the level of control risk relevant to all significant account balances, and performing sufficient tests to assess whether internal controls are effective and working as designed. Our evaluation of the system of internal controls was conducted to determine whether it met the objectives identified in the previous paragraph and not to provide an opinion on the system of internal controls. Accordingly, we do not express such an opinion.

Our evaluation of the controls for performance information was limited to those controls designed to ensure the existence and completeness of the information. With respect to the performance measure control objective, we obtained an understanding of relevant control policies and procedures designed to permit the preparation of reliable and complete performance information and assessed control risk.

In evaluating internal controls, we considered matters reported by the Department in compliance with the Federal Managers' Financial Integrity Act, our prior and current audit reports, and other independent auditor reports on financial matters and internal accounting control policies and procedures. The Appendix to this report lists performance audit reports published by the Office of Inspector General during Fiscal Year 1997 that were considered in our evaluation of internal controls.

As part of our audit, we noted certain matters involving the system of internal controls and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the system of internal controls that, in our judgment, could adversely affect the Department's ability to ensure that the objectives of internal controls, as previously defined, are being achieved. The conditions considered to be reportable conditions are discussed in Exhibits I and II to this report.

A reportable condition is classified as a material weakness when the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statement being audited, or material to performance measures or the aggregation of performance data, may occur and not be detected within a timely period by employees in the normal course of performing

their assigned functions. We considered the condition discussed in Exhibit I to this report to be a material weakness. Management should consider this weakness when preparing its yearend assurance memorandum on management controls.

Our consideration of the system of internal controls would not necessarily disclose all matters in internal controls that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

The audit also disclosed a number of other conditions relating to the Department's system of internal controls that we did not consider to be reportable conditions and which did not materially affect the Department's financial statements. These matters will be communicated to the Office of Chief Financial Officer and to the head of field elements in separate reports. The recommendations made in these reports are designed to strengthen internal controls or improve operating efficiencies.

This report is intended for the information of the management of the U.S. Department of Energy. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

  
\_\_\_\_\_  
16

December 29, 1997, except for Note 13, as to which the date is January 30, 1998, and Note 16, as to which the date is February 19, 1998.

<b>Material Reportable Condition Findings and Recommendations</b>
---

**Environmental Remediation Liabilities**

**Background:** The Department's estimate of environmental liabilities should reflect future costs associated with remediation of environmental contamination existing as of the last day of the fiscal year. In the Fiscal Year 1996 consolidated financial statements, the Department's estimate was based primarily on the 1996 Baseline Environmental Management Report (BEMR), a Congressionally-mandated report produced by the Office of Environmental Management (EM). During the latter part of Fiscal Year 1996, the Department embarked on a new vision and strategy for addressing the environmental cleanup of its sites. This new strategy was communicated in a June 1997 Discussion Draft, *Accelerating Cleanup: Focus on 2006* (2006 Plan). This effort resulted in significantly lower life-cycle cost estimates for most EM activities than had been reported in BEMR. It did not include active facilities or currently excess or soon to be excess facilities not currently in the EM program that had been included in BEMR (pipeline facilities).

To reflect the Department's new strategy, the Office of Chief Financial Officer (CFO) adopted a multi-faceted approach to capture all pieces of the environmental liability estimate. The Department's environmental remediation liability at September 30, 1997, was based on three main components:

- EM's 2006 Plan, which estimates life-cycle costs for the EM program;
- Cost estimates for currently excess or soon to be excess facilities not yet transferred to EM; and
- A cost estimate for remediation of currently active facilities.

Each of the Department's field offices was instructed to record its portion of the liability according to instructions issued by the CFO.

**Finding 1:** Cost Estimates for Environmental Liabilities

As a component of its overall system of internal controls, the Department is responsible for establishing controls to provide reasonable assurance that estimates supporting accruals of unfunded environmental liabilities are complete and readily verifiable. The Department's system for estimating environmental remediation costs did not completely and accurately capture the Department's environmental liability as of September 30, 1997. The following are examples of the problems our audit identified:

<p style="text-align: center;"><b>Material Reportable Condition</b> <b>Findings and Recommendations</b></p>
---

- The EM component of the environmental liability was based on data submitted to Headquarters in February of 1997 in preparation for issuance of the June Discussion Draft of the 2006 Plan and was not updated through the end of the fiscal year.
- None of the five field offices included in our test work had documented that each facility known to be contaminated had been included in one of the three components of the environmental liability.
- The recorded liability at September 30, 1997, before audit adjustments, omitted most of the disposal fees (about \$5 billion) associated with high-level waste and spent nuclear fuel.
- Errors in removing productivity projections and recording program direction costs were made by certain field offices when the liability was initially recorded.
- The methodology used for developing support costs for the currently active facilities component of the estimate produced incorrect results.
- Headquarters staff members recorded comments that questioned the completeness and accuracy of the 2006 Plan project cost estimates and waste volume data. Despite the effort devoted to this review, these comments were never addressed or specifically considered during preparation of the June Discussion Draft of the 2006 Plan.
- Departmental officials within the programs currently responsible for pipeline and active facilities were not actively involved in preparing or reviewing the liability estimates associated with these facilities.
- The Department did not make provision for the effect of several uncertainties that impact the liability, including potential delays in opening or capacity issues at planned waste repositories or the availability of funding for various privatization projects.

These conditions occurred because the Department did not have an adequate system of internal controls in place to ensure that the environmental liability estimate was complete and accurate. As a result, the Department's environmental liabilities, before audit

<b>Material Reportable Condition Findings and Recommendations</b>
---

adjustments, were understated by about \$7.5 billion, and the uncertainty related to the estimated costs for environmental liabilities was increased.

**Recommendations:** The Department should:

1. Develop and implement a process to update the environmental liability estimate through fiscal year end;
2. Ensure that validation procedures are sufficient to determine that all contaminated facilities are included in the environmental liability estimate;
3. Set up a quality control program to identify and correct errors in the cost estimates upon which the environmental liability is based;
4. Clarify lines of authority and responsibility for active and pipeline facilities and develop procedures to involve responsible program officials in estimating the liability associated with these facilities; and
5. Analyze the impact of uncertainties with regard to the estimate and record or disclose the results as appropriate.

**Management Reaction:** Management generally concurred with the recommendations and agreed to instruct the field elements in future guidance to update their estimates through the end of the fiscal year, strengthen internal controls for Plan 2006 work, increase program official involvement, reemphasize to the field the importance of documenting inclusion of all facilities, amend the financial statements to reflect audit adjustments, and evaluate the need for disclosure of uncertainties.

**Auditor Response:** Management's planned actions for future periods are responsive to our recommendations. In addition, in response to draft audit findings issued on these matters, the Department performed supplementary yearend analyses and reconciliation work and recorded audit adjustments necessary to ensure that the liability recorded in the financial statements was materially correct. We were required to extend our fieldwork in this area through January 30, 1998 to consider these additional actions taken by the Department.

<p style="text-align: center;"><b>Reportable Conditions</b> <b>Findings and Recommendations</b></p>
---

**Performance Measurement Reporting**

**Background:** In accordance with OMB guidance, each annual financial statement should include a narrative Overview of the reporting entity. This Overview should provide a clear and concise description of the reporting entity, its mission, activities, accomplishments, and overall financial results and condition. It should also include information on whether and how the mission of the reporting entity is being accomplished. The performance data presented in the Overview of the Fiscal Year 1996 consolidated financial statements was based primarily on commitments drawn from the Secretary's Performance Agreement with the President (Agreement). The Overview presented the Department's commitments, planned goals necessary to accomplish the commitment, and results achieved during the fiscal year. Although the Agreement continued to be used as the basis for reporting performance information, the Department elected to modify the Overview presentation method significantly for its Fiscal Year 1997 consolidated financial statements.

The Department relied on a computer database (system) to collect and report performance information for use in the Overview in Fiscal Year 1996 and Fiscal Year 1997. Our Fiscal Year 1996 Audit of the Department's Consolidated Financial Statements identified problems with the accuracy, validation, and maintenance of data in that system (see Office of Inspector General Report No. CR-FS-97-02). Management generally concurred with the audit findings and agreed to take corrective action in the form of Departmental guidance and training. Despite efforts to provide guidance and additional training to program officials, problems with data used to support performance measures persist.

**Finding 2: Performance Measure Reporting**

OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*, requires the Overview to the financial statements to communicate whether and how the Department is accomplishing its missions using explicit measures of performance. Both OMB Bulletin No. 94-01 and Statement of Federal Financial Accounting Concepts No. 2 (SFFAC 2) require that performance measures presented in the financial statements contain certain attributes in order to be useful to readers of the financial statements. We found in many cases that the usefulness of the programmatic performance measures presented in the financial statements was limited. For example, we found that the performance measures presented in the Overview:

<b>Reportable Conditions Findings and Recommendations</b>
---

- Generally did not present the Department's short-term or long-term goals or make comparisons to such goals and did not sufficiently relate results to the Department's missions, goals or objectives. Instead, the Overview presented a list of accomplishments that were not directly identifiable with the Department's missions, goals or objectives.
- Excluded specific performance information regarding the Federal Energy Regulatory Commission (FERC) and the Department's power marketing administrations (PMAs).
- Were not limited to the most significant objectives or valued attributes of the Department. For example, the Science and Technology section of the Overview included results of a \$40 million program and measures on training that, while by themselves may be important accomplishments, are not necessarily significant objectives of the Department.
- Provided few negative results and no trend data.
- Often lacked the explanatory information needed to help readers understand the significance of the measures.
- Were not always objective or measurable. For example, certain measures indicated that the Department supported, enhanced or facilitated some objective.

The Department's method of summarizing data from the Agreement focused on results rather than the measurement of performance against goals and in many cases eliminated essential detailed goal information. As a result, the presentation of the Overview limits financial statement readers' ability to assess the Department's performance during Fiscal Year 1997.

In the future, inclusion of the key attributes in the Department's method of reporting performance measures will be essential to successful implementation of upcoming reporting changes required by OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*. Beginning with Fiscal Year 1998, the Department will be required to report performance measures that:

- Are consistent with measures previously included in budget documents and other materials related to the implementation of the Government Performance and Results Act;



<p style="text-align: center;"><b>Reportable Conditions</b> <b>Findings and Recommendations</b></p>
---

- Provide information about the cost effectiveness of programs;
- Include an explanation of what needs to be done and what is planned to be done to improve financial and program performance; and
- Are linked to the programs presented in the Statement of Net Cost.

**Recommendation:** The Department should review and incorporate in its preparation of performance measures the OMB and SFFAC requirements ensuring that it communicates whether and how the Department is accomplishing its missions, thereby enhancing the usefulness of the Overview.

**Management Reaction:** Management concurred with the recommendation. The Department is working to improve the performance measures and the Overview and will use the new strategic plan to present short and long-term goals and relate accomplishments to missions, goals and objectives. Management has agreed to include performance results for FERC and the PMA's performance in future reports; will work to address the problem of specific measures and performance; and include further explanatory information needed to help readers understand the significance of measures. The Department will also provide more trend data and report appropriate negative results to clearly set forth performance.

**Auditor Comments:** Management's planned actions are responsive to our recommendation.

**Finding 3:** Collection and Support of Performance Measure Information

OMB Bulletin No. 94-01 requires the Department to maintain adequate supporting documentation for its performance measures and retain such documentation in a manner suitable for audit. As a component of its overall system of internal controls, the Department is also responsible for establishing controls to provide accurate, complete, and timely performance measure information. As previously reported in the Office of Inspector General's FY 1996 Headquarters-level management report (CR-FS-97-02), performance information in the Department's system was not always supported, accurate, complete, or up-to-date. For example:

- Information indicating that the Department exceeded its savings goals for energy efficiency and renewable energy efforts was based on a draft report of Fiscal Year

<b>Reportable Conditions</b> <b>Findings and Recommendations</b>
---

1996 results. As a result of our request for data to support Governmentwide energy savings, program officials reevaluated their submission and revised previously reported savings downward by over \$170 million. Reported annual savings of \$10 billion in the category of consumers' energy costs were not adequately supported.

- The system contained information indicating that the Department was on track to meet Department of Defense weapons alteration, modification, and surveillance schedules. However, the responsible program manager reported this based on his personal knowledge, had no support for the information reported, and informed us that he was not aware of the requirement to maintain support for performance measures.
- The system also contained information indicating that the Department had met its Fiscal Year 1997 goal with regard to the award of performance-based management contracts. The claimed results were supported by a list prepared from memory that was not supported by documentary evidence. Two cited examples of performance-based contracts were actually contract modifications that contained performance-based attributes adopted in Fiscal Year 1996. One contract listed as an example was not a performance-based management contract and had been originally awarded in the 1960s.
- Because the system was not completely updated on a timely basis as required, the Department could not rely on it to generate the Overview and was forced to obtain more accurate and current information directly from the program offices.
- A discrete set of supporting information was not generally available for audit verification. Support was often assembled from numerous sources only after auditor requests for supporting data.

These problems occurred because the Department had not fully developed a system of internal controls for ensuring accurate and timely reporting of performance information in the Overview. As a result, the Department continues to risk reporting information in the Overview and supplemental information that does not present an accurate and up-to-date picture of how it is accomplishing its missions.

**Recommendation:** We recommend that the Department strengthen internal controls to ensure the Headquarters program offices follow Departmental guidance on preparing and reporting accurate and current performance information.

<p style="text-align: center;"><b>Reportable Conditions</b> <b>Findings and Recommendations</b></p>
---

**Management Response:** Management concurred with the recommendation and recognized the potential weakness. The Department is improving and management is hopeful that audit involvement will result in further enhancements to the reporting processes. The Department's performance measure information system, if used appropriately, can provide a greater level of assurance that managers have read reports of results and approve of system inputs. The Department's philosophy has been that managers who are accountable must ensure that results are accurately reported. In Departmental guidance for development of commitments for Fiscal Year 1998, management emphasized that performance goals (measures) should be specific, quantified, stretching, and auditable.

**Auditor Comments:** Management's planned actions are responsive to our recommendation.

<p style="text-align: center;"><b>Office of Inspector General</b>  <b>Fiscal Year 1997 Audit Reports</b></p>
--

<b><u>Report Number</u></b>	<b><u>Report Title</u></b>	<b><u>Date Report Issued</u></b>
IG-0398	Special Report on the Audit of the Management of Department of Energy Construction Projects	November 21, 1996
IG-0399	Audit of the U.S. Department of Energy's Identification and Disposal of Nonessential Land	January 8, 1997
IG-0400	Summary Audit Report on Contractor Employee Relocation and Temporary Living Costs	January 27, 1997
IG-0402	Audit of the Management of the Department of Energy's Leased Administrative Facilities	April 1, 1997
IG-0403	Audit of the Use of Intra-Department Requisitions	May 2, 1997
IG-0404	Audit of Department of Energy Contractor Occupational Injury and Illness Reporting Practices	May 7, 1997
IG-0405	Audit of the Savannah River Site's Quality Control Program for Groundwater Sampling	May 20, 1997
IG-0407	Audit of the Department of Energy's Scientific and Technical Information Process	June 17, 1997
IG-0408	Audit of Shutdown and Transition of the Mound Plant	June 24, 1997
IG-0409	Audit of the Western Area Power Administration's Contract With Basin Electric Power Cooperative	June 25, 1997
IG-0410	Audit of Environmental Restoration at the Los Alamos National Laboratory	July 15, 1997
IG-0411	Audit of the Contractor Incentive Programs at the Rocky Flats Environmental Technology Site	August 13, 1997

<b>Office of Inspector General Fiscal Year 1997 Audit Reports</b>
---

<b><u>Report Number</u></b>	<b><u>Report Title</u></b>	<b><u>Date Report Issued</u></b>
CR-B-97-01	Audit of the Department of Energy's Warehouse Space	January 28, 1997
CR-B-97-02	Audit of Department of Energy's Contractor Salary Increase Fund	April 4, 1997
CR-B-97-03	Followup Audit on the Procurement of Support Services for the Energy Information Administration	May 16, 1997
CR-B-97-04	Audit of Controls Over the ADP Support Services Contract	August 25, 1997
ER-B-97-01	Audit of Economic Development Grants and a Cooperative Agreement With East Tennessee Not-for-Profit Organizations	October 22, 1996
ER-B-97-02	Audit of the Department of Energy's Grant for Economic Development at the Mound Plant	February 14, 1997
ER-B-97-03	Audit of Proposal to Acquire Land at the Fernald Environmental Management Project	June 5, 1997
ER-B-97-04	Audit of Selected Hazardous Waste Remedial Actions Program Costs	August 11, 1997
WR-B-97-01	Audit of Electrical System Construction Projects at the Nevada Operations Office	November 6, 1996
WR-B-97-02	Audit of Bus Service Subsidies at the Idaho National Engineering Laboratory	November 7, 1996
WR-B-97-03	Audit of Groundwater Monitoring at Hanford	November 15, 1996

<b>Office of Inspector General Fiscal Year 1997 Audit Reports</b>
---

<b><u>Report Number</u></b>	<b><u>Report Title</u></b>	<b><u>Date Report Issued</u></b>
WR-B-97-04	Audit of the Use of Hanford Site Railroad System	March 20, 1997
WR-B-97-05	Audit of Work Force Restructuring Under Section 3161 of the National Defense Authorization Act	May 6, 1997
WR-B-97-06	Audit of Renovation and New Construction Projects at Lawrence Livermore National Laboratory	June 9, 1997
WR-B-97-07	Audit of Desktop Computer Acquisitions at the Idaho National Engineering and Environmental Laboratory	August 25, 1997

**U. S. Department of Energy  
Office of Inspector General  
Office of Audit Services**

---

**REPORT OF THE OFFICE OF INSPECTOR GENERAL ON  
COMPLIANCE WITH LAWS AND REGULATIONS**

---

The Secretary  
U.S. Department of Energy

We audited the consolidated financial statements of the U.S. Department of Energy (Department) for the year ended September 30, 1997, and have issued our report thereon dated December 29, 1997, except for Note 13, as to which the date is January 30, 1998, and Note 16, as to which the date is February 19, 1998.

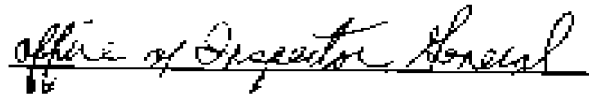
We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The management of the Department is responsible for complying with applicable laws and regulations. As part of obtaining reasonable assurance about whether the consolidated financial statements were free of material misstatements, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 93-06, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph disclosed no instances of noncompliance required to be reported under *Government Auditing Standards* and OMB Bulletin No. 93-06, as amended.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with the Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997. The results of our tests disclosed no instances where the Department's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

This report is intended for the information of the U.S. Department of Energy. However, this report is a matter of public record, and its distribution is not limited.

A handwritten signature in cursive script, which appears to read "Office of Inspector General", is written over a horizontal line.

December 29, 1997, except for Note 13, as to which the date is January 30, 1998, and Note 16, as to which the date is February 19, 1998.